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REPORT TO THE STOCKHOLDERS

Colonial Stores Incorporated



YEAR ENDED DECEMBER 27, 1941

Norfolk, Virginia, March 10, 1942.

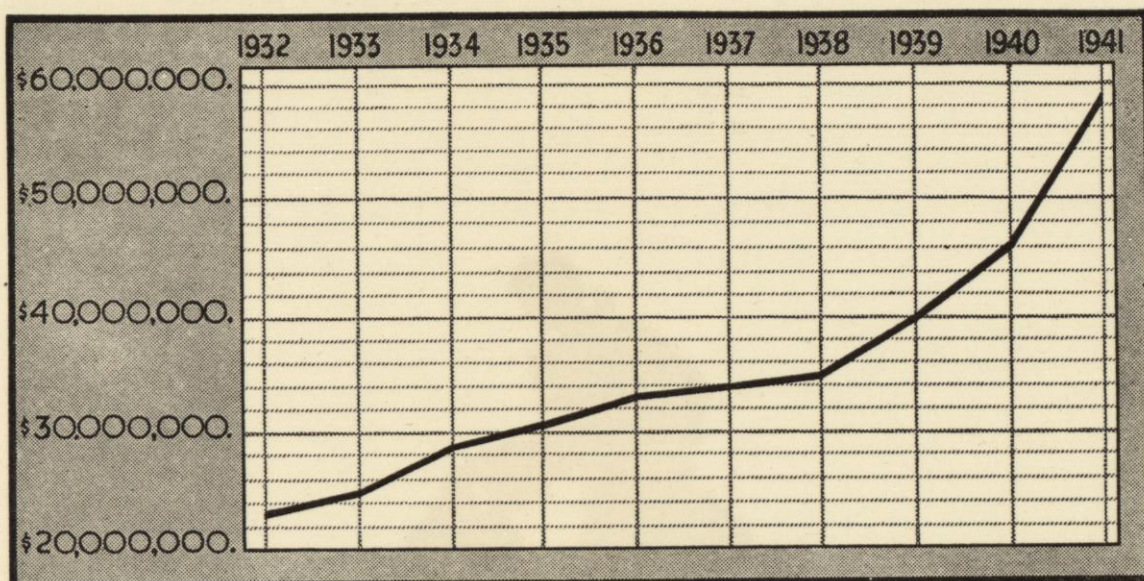
To the Stockholders of

COLONIAL STORES INCORPORATED:

The Annual Report of your Company for the fiscal year ended December 27, 1941, together with financial statements and Auditors' Report thereon, is presented herewith.

SALES:

The volume of business for the year 1941 increased at a satisfactory rate, thus continuing the uninterrupted progress of your Company over the past decade, as shown in the graph below. The 26% increase in sales for the year was due both to rising retail prices and a substantial increase in tonnage, representing new customers gained and greater purchases by established customers.



INCOME ACCOUNT:

The following condensed Comparative Statements of Operation set forth the results for the 1941 and 1940 fiscal years:

	1941	1940
Sales	\$58,178,638	\$46,238,374
Net Profit, before Depreciation and Taxes upon Income....	1,689,410	1,297,283
Appropriated for Depreciation and Amortization.....	415,681	313,495
Balance	1,273,729	983,788
Estimated Federal and State Taxes upon Income.....	662,450	305,000
Net Income	\$ 611,279	\$ 678,788

NOTE—Figures for 1940 and prior years include the combined accounts of David Pender Grocery Company and Southern Grocery Stores, Inc., prior to the merger.

Operating profits in 1941 were substantially higher as a result of the large increase in sales volume and an improved operating ratio. However, Depreciation and Amortization increased 33% and Taxes upon Income 117%, causing a decline of \$67,509 in Net Income as compared with the year 1940. After allowance for the annual dividend require-

ments on the Company's 5% Cumulative Preferred Stock, Series "A," the balance of Net Income for 1941 was equivalent to \$1.92 per share of Common Stock as compared with \$2.20 per share on a similar basis for 1940. It should be noted that Net Income for 1940, as set forth above, has been adjusted (since the publication of the Annual Report for that year), by giving effect to a reduction of the estimated Federal Excess Profits Tax liability in the amount of \$45,000, as hereinafter explained in the paragraph on Taxes.

Regular dividends upon the 5% Cumulative Preferred Stock, Series "A," and quarterly dividends aggregating \$1.00 per share upon the Common Stock, were paid during the year.

For several years your directors had been considering a plan of Incentive Bonus Compensation in recognition of the coordinated and progressive work of the entire organization. After careful study your Board adopted a plan during the year under which payments aggregating \$168,067 were made to the Company's employees, including \$22,000 to six of its principal executives. In addition, your Board is recommending that the Corporation's shareholders, at their annual meeting, authorize the delivery to the Company's President and Executive Vice-President, of options to subscribe to 12,000 shares of Common Stock upon the same terms and conditions as provided in the Warrants attached to the Corporation's 5% Cumulative Preferred Stock, Series "A."

TAXES:

Subsequent to the certification of the 1940 accounts by the Corporation's auditors, certain amendments to the Second Revenue Act of 1940, known as "Excess Profits Tax Amendments of 1941" were enacted, affording a more liberal allowance for Excess Profits Tax credits to certain corporations having increased earnings during the last half of the "Base Period." These credits were not, therefore, taken advantage of in calculating the Excess Profits Tax liability, reflected in the 1940 Annual Report. The estimated tax savings amounted to \$45,000 which was credited to Earned Surplus Account in 1941.

While these savings accrued to the benefit of our two constituent companies prior to their merger, the amendments were so worded that the relief was denied to the Company after the merger. Thus an inequitable situation exists as to your Company's tax liability under the Revenue Act of 1941. If the credits provided under the aforesaid amendments had been available to your Company, estimated Income and Excess Profits Tax liability would have been approximately \$88,000 less and Net Income for the year 1941 would have been proportionately greater. Your Management hopes that legislation now being considered will be enacted by Congress whereby this manifest inequity will be corrected retroactively.

NEW FINANCING:

As of October 1, 1941 the Corporation issued and sold \$2,000,000 principal amount Fifteen-Year 3 $\frac{5}{8}$ % Sinking Fund Debentures due October 1, 1956. Net proceeds from the sale of these Debentures were used to retire the \$1,000,000 Term Bank Loan then outstanding, for additional working capital and to pay, in part, for capital improvements.

Under the terms of the Debenture Issue, annual Sinking Fund installments are required to be made, in effect, out of earnings, in amounts ranging from \$100,000 in the year 1943 to \$110,000 in the year 1944 and thereafter increasing in three year intervals to a maximum of \$140,000 in 1953. Upon maturity of the Debentures in 1956 the balance to be retired will be \$400,000. The Indenture under which the Debentures

were issued includes certain requirements in connection with the financial position of the Company, which will be found in the third note pertaining to the balance sheet.

PROPERTIES:

On December 27, 1941 there were 527 stores, including 66 supermarkets, in operation. During the year 41 small neighborhood stores were closed and 16 new supermarkets were opened. The population in certain parts of the Company's territory has greatly increased due to the concentration of War activities. It is estimated by reliable agencies that the increase in the so-called Hampton Roads area in Virginia, in which your Company is the most important retail distributor of food, has been more than 50% since the 1940 census. The purchasing power of rural customers has been substantially improved as a result of higher prices for farm products generally throughout the Company's territory. These two factors in combination have strained the facilities of many stores to the utmost. To solve this situation a certain number of the better and well-located counter-type units have been converted into self-service stores with greater sales capacity.

The steady increase in sales volume over a period of years caused a severe overloading of the Company's warehouses, creating an urgent need for more warehouse space. During 1941 favorable leases were negotiated for additional facilities, consisting of a small warehouse built for the Company and now in operation at Thomasville, Georgia, and a larger warehouse now under construction at Durham, North Carolina. The Thomasville warehouse has relieved some of the overload upon the warehouse at Atlanta, Georgia, and the one in Durham will replace the present inadequate and less favorably situated warehouse in Charlotte, North Carolina and, also, service a large number of stores now supplied from Norfolk, Virginia. Approximately 35% additional space is being provided by the owners of the Norfolk warehouse at no increased rental and with a relatively small expenditure for equipment.

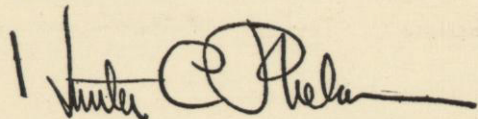
These improvements were necessary under normal conditions for greater efficiency and reduction of transportation and warehousing costs. Under current war conditions they have become of vital importance.

PUBLIC RELATIONS:

Wartime conditions present many problems affecting the Company's relationship with the public which it serves. Shortages of certain merchandise lines and price advances affecting others are often temporarily misunderstood. The Company's high standard of courtesy and service is at times difficult to maintain due to overtaxed facilities and the increasing number of inexperienced employees who are replacing those who have joined the country's armed forces and others attracted by higher wages in war industries. Every effort is being made to meet this situation and a rigid policy of retail price control is being enforced which insures our customers the lowest possible food prices. However, a marked improvement in our public relations is apparent throughout the territory.

The splendid loyalty and industry of all employees and their willingness to adjust themselves to rapidly changing conditions have been responsible in a very large degree for the improved operating results for the year.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "J. E. P. R.", is written over a horizontal line.

President

Colonial Stores Incorporated

PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED DECEMBER 27, 1941

Net Sales.....		\$ 58,178,638.20
Cost of Goods Sold, including certain Occupancy and Buying Expenses	\$ 47,799,683.76	
Selling, General and Administrative Expenses, exclusive of certain Occupancy and Buying Expenses.....	8,637,223.77	
Provision for Depreciation and Amortization of Property, Plant and Equipment	<u>415,681.26</u>	<u>56,852,588.79</u>
Operating Profit.....		1,326,049.41
Other Income — Credits from refund of Processing Taxes \$7,081.84 and other Miscellaneous Items.....		<u>12,479.19</u>
		1,338,528.60
Income Deductions:		
Interest Expense:		
3% Installment Notes (including Retirement Premium, \$9,896.40)	29,100.62	
Fifteen Year Debentures (including Amortization of Debt Expenses)	13,549.36	
Other Bank Loans and Miscellaneous.....	<u>5,356.17</u>	
	48,006.15	
Loss on disposal of Capital Assets.....	9,841.05	
Settlement of Damage Claims.....	<u>6,952.38</u>	<u>64,799.58</u>
Net income, before Provision for Income and Excess Profits Taxes		1,273,729.02
Provision for Federal and State Income Taxes, and Federal Excess Profits Tax of \$336,000.00		<u>662,450.37</u>
Net Income, carried to Earned Surplus.....		<u>\$ 611,278.65</u>

Colonial Stores

BALANCE SHEET
AS OF DECEMBER 31, 1954

ASSETS

CURRENT ASSETS:

Cash in Banks and on Hand, less Preferred Stock Sinking Fund appropriation, \$22,255.73		\$ 1,633,870.44
Accounts Receivable:		
Customers' Accounts Receivable	\$ 85,057.61	
Claims, Allowances and Other Trade Receivables	133,385.97	
Miscellaneous (including advances to Officers and Employees \$3,264.14)	35,071.35	
	<u>253,514.93</u>	
Less Reserve for Doubtful Accounts	22,152.92	231,362.01
Inventories: (Note "1")		
Stores and Markets	2,472,839.92	
Warehouses and Bakeries	1,803,641.54	
Merchandise in Transit	<u>251,079.73</u>	4,527,561.19
TOTAL CURRENT ASSETS		<u>6,392,793.64</u>
SINKING FUND FOR RETIREMENT OF 5% CUMULATIVE PREFERRED STOCK, SERIES "A" (Note "2(c)")		22,255.73

INVESTMENTS:

Cash Surrender Value of Life Insurance Policies (Face Amount \$337,500.00)	120,837.64	
Investment in Class "B" Stock of National Food Products Corporation — Affiliated Company — at cost, less Reserve \$22,180.50	7,992.00	
Land not used in Operations — at cost to a predecessor company	60,000.00	
Miscellaneous — at cost, less Reserve \$513.93	<u>1,995.00</u>	190,824.64

PROPERTY, PLANT AND EQUIPMENT AT COST:

Land	124,910.17	
Buildings	337,514.41	
Fixtures and Equipment	3,538,846.99	
Delivery Equipment	386,450.89	
Improvements to Leased Premises	<u>213,482.24</u>	
	4,601,204.70	
Less Reserves for Depreciation and Amortization	<u>1,910,146.08</u>	2,691,058.62

PREPAID EXPENSES AND DEFERRED CHARGES:

Insurance, Taxes and Licenses	139,128.15	
Supplies	208,789.67	
Unamortized Debt Expenses	23,992.85	
Miscellaneous	<u>29,897.18</u>	401,807.85

GOODWILL AND LEASEHOLDS — AT NOMINAL AMOUNT		2.00
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\$ 9,698,742.48

(SEE NOTES ON BALANCE SHEET)

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E SHEET

MBER 27, 1941

LIABILITIES

CURRENT LIABILITIES:

Accounts Payable — Trade.....		\$ 1,244,655.14
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Accrued Liabilities:

Salaries and Wages.....	\$ 47,924.54	
Taxes, other than Income Taxes.....	125,072.60	
Interest	17,548.42	
Miscellaneous	<u>2,626.44</u>	193,172.00

Provision for Income and Excess Profits Taxes (subject to Review by Treasury Department).....		686,071.31
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TOTAL CURRENT LIABILITIES.....		<u>2,123,898.45</u>
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FIFTEEN-YEAR 3½% SINKING FUND DEBENTURES, DUE OCTOBER 1, 1956 (SINKING FUND INSTALLMENTS COMMENCE IN 1943 AT \$100,000.00)		2,000,000.00
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RESERVES FOR SELF-INSURANCE OF MINOR RISKS.....		20,263.42
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CAPITAL STOCK AND SURPLUS:

CAPITAL STOCK:

PREFERRED STOCK:

Authorized, 90,000 shares, Par Value \$50.00 per share — Issuable in Series		
Issued, 56,000 shares 5% Cumulative Preferred Stock, Series "A," with Purchase Warrants entitling holder to purchase an equal number of shares of Common Stock (Note "2")....	2,800,000.00	

COMMON STOCK:

Authorized, 500,000 shares. Par Value \$5.00 per share (56,000 shares reserved for issuance upon exercise of Stock Purchase Warrants)		
Issued, 245,181 shares.....	1,225,905.00	
	<u>4,025,905.00</u>	

SURPLUS — per accompanying statement:

Capital Surplus	\$ 28,526.13	
Earned Surplus (Note "3").....	<u>1,500,149.48</u>	<u>1,528,675.61</u>
		5,554,580.61

CONTINGENT LIABILITIES:

Miscellaneous claims for damages, Etc. Maximum liability estimated to be \$11,500.00		<u>\$ 9,698,742.48</u>
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Colonial Stores Incorporated

BALANCE SHEET, Continued

Notes:

1. Inventories:

Inventories of merchandise in warehouses, bakeries and retail markets represent physical inventories priced at the lower of cost or market, cost being determined by the first-in, first-out method and market by current replacement cost. Stores inventories have been determined on the basis of centrally controlled perpetual inventory records of the retail selling value of merchandise at each store, less a percentage calculated to reduce such retail value to the lower of cost or market. The amounts shown by the perpetual inventory controls are substantiated by physical inventories at retail taken generally each month. Merchandise in transit is stated at cost, which is not in excess of current replacement cost.

2. Preferred Stock:

- (a) Holders of the 5% Cumulative Preferred Stock, Series "A," are entitled to preferences in liquidation or redemption in the following amounts together with, in each case, accrued unpaid dividends thereon: Voluntary liquidation or redemption on or before December 1, 1943, \$55.00 per share; thereafter, \$52.50 per share; involuntary liquidation \$50.00 per share.
- (b) Each share of 5% Cumulative Preferred Stock, Series "A," carries with it a non-detachable purchase warrant entitling the holder to purchase one share of Common Stock of the Company on or before December 1, 1943 at \$15.00 per share; thereafter and to December 1, 1945 at \$17.00 per share; thereafter and to December 1, 1947 at \$19.00 per share.
- (c) There shall be set aside on or before April 1st of each year a retirement sinking fund in an amount equal to 20% of net earnings in excess of \$500,000.00 for the preceding calendar year, but not more than \$120,000.00 in any one year.

3. Surplus:

- (a) The terms of the Indenture covering the Fifteen-Year 3½% Sinking Fund Debentures impose certain limitations upon the financial activities of the Company, including restrictions as to the payment of dividends (other than stock dividends) or the purchase or retirement of its capital stock if such action would impair the specified ratios of current assets to current liabilities, working capital or undistributed earnings beyond stated limits. Of the Earned Surplus at December 27, 1941, an amount of \$1,189,307.56 is thereby restricted.
- (b) The terms of issuance of the 5% Cumulative Preferred Stock, Series "A," provide that, so long as any of such stock remains outstanding, the Company will not make any distribution to holders of the Common Stock in excess of net earnings after September 1, 1940 plus the sum of \$250,000.00.

Colonial Stores Incorporated

SURPLUS ACCOUNTS

FOR THE YEAR ENDED DECEMBER 27, 1941

CAPITAL SURPLUS

Balance as of December 28, 1940.....	\$ 27,608.44
Restoration of proportion of Capital Surplus at date of merger applicable to 100 shares of Common Stock of Southern Grocery Stores, Inc., held by dissenting stockholders, ultimately surrendered for conversion	917.69
Balance as of December 27, 1941.....	<u>\$ 28,526.13</u>

EARNED SURPLUS

Balance as of December 28, 1940.....	\$ 1,222,381.35
Adjustments applicable to prior years:	
Reduction in Estimate of Federal Excess Profits Tax required for the year 1940, resulting from the enactment of amendments in 1941, to the Second Revenue Act of 1940.....	\$ 45,000.00
Restoration of proportion of Earned Surplus at date of merger applicable to 100 shares of Common Stock of Southern Grocery Stores, Inc., held by dissenting stockholders, ultimately surrendered for conversion.....	882.31
	<u>45,882.31</u>
Less additional expenses incidental to merger.....	<u>1,211.83</u>
	44,670.48
	<u>1,267,051.83</u>
Net Income for Year.....	611,278.65
	<u>1,878,330.48</u>
Dividends Paid:	
5% Cumulative Preferred Stock Series "A" — \$2.37½ per share.....	133,000.00
Common Stock — \$1.00 per share.....	<u>245,181.00</u>
Balance as of December 27, 1941.....	<u>\$ 1,500,149.48</u>

ACCOUNTANTS' REPORT

To the Board of Directors,
Colonial Stores Incorporated,
Norfolk, Va.

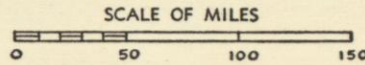
We have examined the Balance Sheet of Colonial Stores Incorporated as of December 27, 1941, and the statements of Profit and Loss and Surplus for the fiscal year then ended, have reviewed the system of internal control and the accounting procedures of the Company and, without making a detailed audit of the transactions, have examined or tested accounting records of the Company and other supporting evidence, by methods and to the extent we deemed appropriate. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances and included all procedures which we considered necessary.

In our opinion, the accompanying Balance Sheet and related statements of Profit and Loss and Surplus present fairly the position of Colonial Stores Incorporated at December 27, 1941 and the results of its operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

PEAT, MARWICK, MITCHELL & CO.
Philadelphia, Pa.
March 4, 1942.

Colonial Stores Incorporated

GEOGRAPHICAL DISTRIBUTION OF STORES

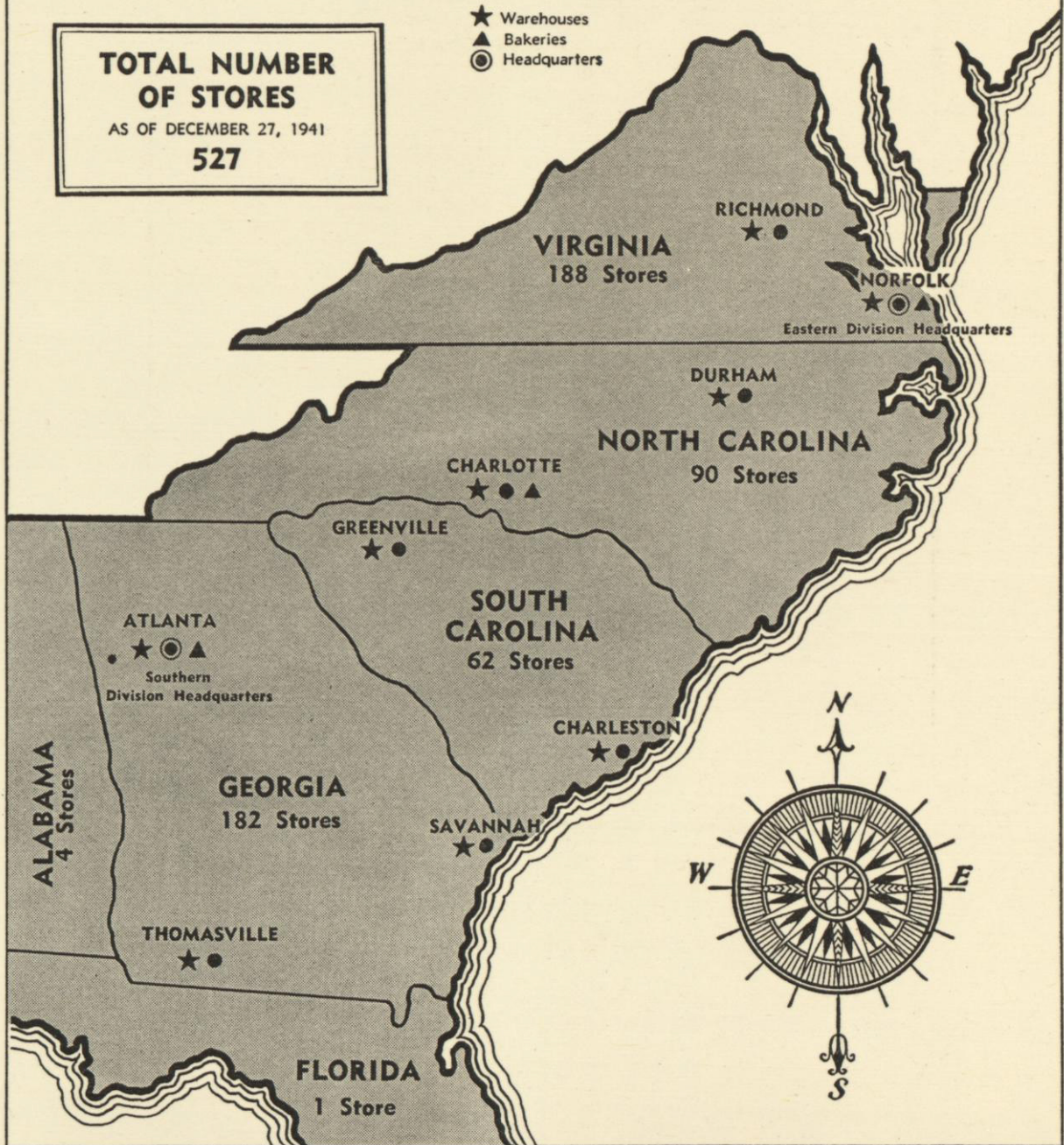


- ★ Warehouses
- ▲ Bakeries
- Headquarters

TOTAL NUMBER OF STORES

AS OF DECEMBER 27, 1941

527



Colonial Stores Incorporated

301-321 DUNMORE STREET
NORFOLK, VIRGINIA

DIRECTORS

SCOTT W. ALLEN	W. C. PENDER
L. M. BLANCKE	HUNTER C. PHELAN
RALPH P. BUELL	MARION SMITH
RYBURN G. CLAY	RUSSELL B. STEARNS
EDWARD K. DUNN	JOHN TWOHY, II
C. T. WILLIAMS, JR.	

OFFICERS

HUNTER C. PHELAN	<i>President</i>
SCOTT W. ALLEN	<i>Executive Vice-President</i>
J. W. WOOD	<i>Vice-President</i>
JOSEPH SEITZ	<i>Vice-President</i>
W. C. PENDER	<i>Secretary</i>
R. B. JACKSON	<i>Treasurer</i>
LAWRENCE LOCKWOOD	<i>Comptroller</i>

AUDITORS

PEAT, MARWICK, MITCHELL & Co.

TRANSFER AGENT

BANKERS TRUST COMPANY, NEW YORK, N. Y.

REGISTRAR

CHEMICAL BANK AND TRUST COMPANY, NEW YORK, N. Y.